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Supreme Court of the United States

OCTOBER TERM, 1942.

No. 190.

EDMUND WRIGHT GINSBERG CORPORATION,
Petitioner,

vs.

JOHN M. SWETNAM, as Trustee in Bankruptcy of The Deford Company.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement.

This is an action by a bankruptcy trustee to set aside various transfers of accounts receivable made during the four months prior to bankruptcy.

These transfers were claimed to be preferences under Section 60 (b) of the National Bankruptcy Act (11 U. S. C. A., Section 96 (b)), as it existed prior to the Chandler Act amendments in 1938.

The principal defense offered by petitioner was that it had a lien on merchandise, by way of common-law pledge, and that the accounts receivable were created by the sale of the pledged merchandise and hence the transfers were not preferences.

The trustee met this defense by invoking the long established rule regarding such pledges laid down in *Casey* v. *Cavaroc*, 96 U. S. 467, 490 (1878).:

> "The requirement of possession is an inexorable rule of law, adopted to prevent fraud and deception;

for, if the debtor remains in possession, the law presumes that those who deal with him do so on the faith of his being the unqualified owner of the goods."

It was the contention of the trustee that the proof established no possession in petitioner and it therefore had no lien on the merchandise.

Honorable Mortimer W. Byers, United States District Judge, sitting in the Southern District of New York, without a jury (R. 11-314), dismissed the complaint on the merits after trial, holding that the petitioner had established the defense of pledge or security title (R. 315-337).

The Circuit Court of Appeals, Second Circuit, in a unanimous decision by Clark, Swan and Augustus N. Hand, Circuit Judges, reversed and remanded the cause for entry of judgment for the plaintiff (R. 346-351).

The opinion of the Circuit Court of Appeals is reported in 128 F. (2d) 1.

Summary of Petitioner's Argument in Support of a Writ.

Three principal reasons are assigned for the issuance of a writ:

(1) That the Circuit Court of Appeals exceeded its power by reviewing the evidence, in disregard of Federal Rule of Civil Procedure 52 (a);

(2) That there is confusion among the Circuits as to the effect of findings of fact under Rule 52 (a) of the Federal Rules of Civil Procedure; and

(3) That the Circuit Court of Appeals erred in holding that the taking of the accounts receivable, during the four months preceding bankruptcy did not perfect an imperfect pledge.

Summary of Respondent's Argument in Opposition.

(1) The Circuit Court of Appeals exceeded no powers granted to it, by testing the findings against the evidence, and setting them aside for clear error.

The Federal Rules of Civil Procedure (28 U. S. C. A., following Section 723 c) provide:

Rule 52 (a):

> "In all actions tried upon the facts without a jury * * * Findings of fact shall not be set aside unless clearly erroneous. * * *"

Rule 52 (b):

> "* * * When findings of fact are made in actions tried by the court without a jury, the question of the sufficiency of the evidence to support the finding may thereafter be raised. * * *"

(2) The Circuit Court of Appeals for the Second Circuit transgressed no rule with relation to findings, and came into conflict with no holdings in other Circuits, for the Court below made no pronouncement concerning Rule 52 (a), but followed it.

No confusion exists, as the rule is quite simple and clear, and while the courts in various Circuits may have employed different language in applying the rule, the rule has been uniformly followed.

(3) Whether an imperfect pledge has been effectively perfected, within four months preceding bankruptcy, depends upon the law of the state where the property is situated. Petitioner's claim of contrary decisions ignores the requirement that the Federal Courts follow State laws.

Petitioner seeks a review in this Court of a judgment of the Circuit Court of Appeals based upon questions of fact.

Facts.

The petitioner, in lieu of a statement of facts, sets out the findings signed by the District Judge. But these have been set aside as clearly erroneous by the unanimous decision of the Circuit Court of Appeals. We, therefore, give a brief recital of the evidence in the record.

The Deford Company, a West Virginia corporation (R. 167), operated a tannery at Luray, Va. (R. 75) and had an office in Baltimore, Maryland (R. 45).

On November 25, 1936, The Deford Company entered into a contract with petitioner (effective from October 14, 1936), whereby the latter, designated as factor, agreed to advance moneys to the former against the security of hides and leather to be consigned to, or pledged with, petitioner (R. 218-236).

This contract was nowhere recorded or filed (R. 150).

The contract provided that petitioner was to have a lien on all hides and leather set forth in "a statement of pledged inventory hereto attached" (R. 219) and also "in and to hides and leather as it (Deford) may from time to time purchase or manufacture" (R. 219, 225). The evidence showed that no such statement was attached (R. 150-152), and that the petitioner had no record on its books of this inventory (R. 152).

All accounts arising from shipments of leather were to "immediately become the property of Factor, and hereby are sold, assigned and transferred to Factor" (R. 228).

The contract further provided that petitioner should have a custodian (R. 223), and that signs were to be erected and kept "on such premises in such manner as to show to the public that Factor has the sole and exclu-

sive right to the use and enjoyment of said premises to the full and complete exclusion of any other persons whatsoever" (R. 222-223). The evidence showed that the last quoted portion of the agreement was never carried out.

One John B. Long, an employee of the bankrupt, The Deford Company, was assistant to Raymond L. Kendrick, the warehouse superintendent of the bankrupt (R. 154).

Long was taken from The Deford Company payroll and designated as petitioner's custodian (R. 74), but his total salary for the period November 1, 1936 to December 31, 1937 was charged back to The Deford Company (R. 142). Thereafter, commencing on January 1, 1938, charges back of Long's salary ceased (R. 142). But this change took place after a continuous decline in the price of leather (R. 21), and at about the time petitioner's president became worried about The Deford Company's indebtedness to petitioner (R. 21-22).

No other change was made with respect to Long; he was and continued to be the assistant to, and under the direction and control of, Kendrick (R. 113-114, 125-126, 154-155). Both Kendrick and Long performed their duties in the same manner as they had prior to the making of the contract; Kendrick shipped goods without the knowledge or consent of, or consultation with, or authority from, Long (R. 113-114, 162).

Long, petitioner's so-called custodian, admitted that Kendrick was the man who said what was going to be shipped out of warehouse and what was not, and that he (Kendrick) did not have to consult Long as to what he was going to ship (R. 114). Kendrick had charge of the warehouse records (R. 121).

Long did not take charge or custody of the hides, nor did he count them (R. 113-120). Kendrick continued to be The Deford Company warehouse superintendent (R. 154), and, in addition to his other duties, sold leather

in local territory for cash and shipped it without the approval of anyone (R. 158, 161).

The informal nature of the arrangement between petitioner and The Deford Company is further indicated by the fact that Long made no reports to petitioner nor was he asked by petitioner to do so (R. 116); and by the further fact that no representative of petitioner ever visited the plant at Luray after the first visit (R. 149).

There were five sets of keys to the various buildings where the leather was stored from time to time: one set was in the possession of Long; another in the possession of Kendrick; a third in the possession of The Deford Company's Vice-President; a fourth in the main office of The Deford Company tannery at Luray; and a fifth, The Deford Company's night watchman had (R. 155-156, 114-115). Anyone of The Deford Company's employees could have had access to the warehouses by taking the keys from The Deford Company's main office at the tannery. In addition, there were no locks on, or keys for, the hide house (R. 115).

The undisputed testimony is that Long unlocked and locked the premises only when he was the first to arrive and the last to leave (R. 115-116, 155). Otherwise Kendrick "generally" did so, for he had a set of keys for these warehouses (R. 115-116).

Kendrick testified:

> "Q. Now, when you shipped that leather out of the warehouse pursuant to these shipping orders, did you have to wait until Mr. Long came around or did you ship them out yourself? A. No, I would go right ahead.
>
> Q. Go right ahead? A. That is right.
>
> Q. Whether Mr. Long was there or not? A. That is right.
>
> Q. And you did that shipping constantly without Mr. Long being there? A. I did.

Q. And you did that right along as you had as warehouse superintendent before November, 1936 and after November, 1936? A. Yes.

Q. Is that right? A. That is right.

Q. You did not have to ask him for any authority, did you? A. No" (R. 162).

The Deford Company's premises adjoined a public highway in the town of Luray, Virginia, and covered approximately sixteen acres (R. 92-93). As one entered upon the premises over a private thoroughfare, all that met the eye were signs of The Deford Company (Plaintiff's Exhibits 7, 8, 9 and 10, R. 176-183, 92-95).

The name "The Deford Co." alone appeared on a sign on the road at the entrance (Plaintiff's Exhibits 8, R. 178-179, 93-94).

A sign reading "Edmund Wright Ginsberg Corporation, Factors" was affixed to the front door of the warehouse office, Building No. 25; but this sign was obscured entirely by a screen door (Plaintiff's Exhibits 12, 13, R. 186-189, 96-99).

Warehouse No. 22 had a small sign on a side door bearing the legend, "Edmund Wright Ginsberg Corporation, Factor for The Deford Company" (Plaintiff's Exhibits 14, 15; R. 190-193, 99-101). The front of the building, however, bore the words "The Deford Co. Leather", in large letters which could be seen for great distances (Plaintiff's Exhibits 15, 20; R. 192-193, 202-203, 100-102, 105-106). Similar small signs were placed in obscure places on other buildings (Plaintiff's Exhibits 17, 18, 22, 24; R. 196-199, 206-207, 210-211, 102, 107-108, 109-110, 124-125).

Contrary to the contention now urged by petitioner the essential facts are undisputed.

The trial judge, on whose opinion petitioner leans so strongly, made the observation that "there is no sub-

stantial dispute as to the facts" (R. 319), and Judge Clark in the Court below said:

> "All the acts here recited are conceded by the parties in a well-presented case" (R. 349).

There is no question as to the credibility of the various witnesses.

The conclusions of possession and notoriety, based on undisputed facts, were challenged in the court below.

Preliminarily, before passing to each of petitioner's contentions, attention should be directed briefly to the trustee's proof of preference.

On March 21, 1938, the petitioner's claim against The Deford Company was approximately $150,000 (R. 28, 24). During the next ensuing four months (the petition in bankruptcy was filed on July 20, 1938 (R. 167)), the claim was reduced by these challenged assignments by approximately $94,000 (R. 26, 28). In other words, petitioner received approximately 60% of its claim.

Other creditors fared as follows: the unsecured claims filed in The Deford Company bankruptcy amount to $594,473.63 (R. 30). A dividend of 2% has been paid and the trustee has on hand $4,602.53 (R. 30).

Petitioner stipulated that on the 20th day of March, 1938, and on each and every day thereafter up to and including the 20th day of July, 1938, The Deford Company was insolvent (R. 167-168).

As a matter of fact, petitioner had actual knowledge of the insolvency of The Deford Company as early as October, 1937 (R. 12-24).

Petitioner received periodic statements showing large deficits, constantly increasing (R. 13, 22-24).

Petitioner knew that The Deford Company was compelled to suspend operations and to close the plant in

October, 1937 (R. 19-21), and knew that there was a continuously declining leather market, commencing in August or September, 1937 (R. 21). It was after that time that petitioner's president began to worry about The Deford Company's indebtedness to petitioner (R. 21-22).

Prima facie, reasonable cause to believe, that the transfers would effect a preference, was established.

A review of the record will demonstrate that the conclusions of the trial court were clearly erroneous.

POINT I.

Rule 52 (a) of the Federal Rules of Civil Procedure merely codifies as a rule the long established practice and procedure in equity cases and applies the same to non-jury cases.

Prior to September 16, 1938, the effective date of the Federal Rules of Civil Procedure (28 U. S. C. A., following Section 723 c), which abolished the distinction between law and equity and designated one form of action to be known as a "civil action", this litigation would have been classified as a suit in equity, since an accounting was demanded, as was a reassignment of the uncollected accounts receivable.

> *Schoenthal* v. *Irving Trust Co.*, 287 U. S. 92 (1932);
>
> *Kemp-Booth Co., Limited* v. *Calvin*, 84 F. (2d) 377, 380 (C. C. A. 9th, 1936);
>
> *McNulty* v. *Feingold*, 129 Fed. 1001 (United States District Court, E. Dist., Pa., 1904).

This suit, having been commenced on February 19, 1940, was governed by the Federal Rules of Civil Procedure, and was therefore a non-jury civil action.

The power of an appellate court in an equity case, before the promulgation of the Federal Rules of Civil Procedure, was definitely and clearly established by the decisions of this Court.

In *Bowerman* v. *Hamner*, 250 U. S. 504 (1919), the District Court dismissed the complaint, and the Circuit Court of Appeals reversed, and remanded with a direction for the entry of judgment in favor of the plaintiff—a situation similar to that here presented. This Court affirmed the determination of the Circuit Court of Appeals, and said, per Mr. Justice Clarke:

> "The suit was in equity and he (the defendant) was charged with notice that the decision of the trial court was subject to review on both the law and the facts * * *" (250 U. S. 514).

And the broad supervisory powers of the appellate court in an equity case were also indicated by Mr. Justice Cardozo in *Radio Corporation of America* v. *Radio Engineering Laboratories, Inc.*, 293 U. S. 1 (1934), where he said:

> "Nice distinctions are suggested between the application of these principles by the court that finds the facts and their application by the court that sits as a reviewing body, though we know that an appeal in equity imports a broad power of revision" (293 U. S. 9).

There is little doubt that had this case arisen prior to the effective date of the Federal Rules of Civil Procedure, the Circuit Court of Appeals would have had ample power to reverse the judgment of the District Court and direct the entry of judgment for the plaintiff. *Bowerman* v. *Hamner, supra.*

The Federal Rules of Civil Procedure have in nowise abrogated or limited this power.

The third sentence of Rule 52 (a) of the Federal Rules of Civil Procedure ("Findings of fact shall not be set aside unless clearly erroneous, * * *") is the modern equity rule; it enunciates no new doctrine and requires no construction or definition by this Court.

The Rules, in abolishing the distinction between law and equity and designating the one form of action in civil cases, by the third sentence of Rule 52 (a) adopted the modern equity rule, and extended its application to cases formerly denominated non-jury law cases.

The extension of the rule to non-jury law cases was the only change effected.

This is clearly indicated in the April 1937 "Report of the Advisory Committee on Rules for Civil Procedure appointed by the Supreme Court of the United States."

Rule 52 (a) there appeared as Rule 59 (a), and the note of the Committee to this Court indicates the problem faced and its decisions:

> "* * * as to the effect of findings of fact by the court. There are at least three solutions. The first is to retain the present system of review, viz., that in jury-waived cases, the findings of fact shall have the same effect as the verdict of a jury in an action at law; while in equity cases, the findings of fact are reviewable as to the weight of the supporting evidence as well as the sufficiency. The objection to this is that it perpetuates the very procedural distinctions we are attempting to abolish. The second solution is to provide that the findings of fact in all cases should be reviewed in the same way, and that they should have the same effect as the verdict of a jury. Such treatment, though providing for a uniform and simple method of review and fulfilling the mandate of our enabling statute, has not met with approval by a majority of the Committee. The third is the system here proposed. This fulfills the mandate of the

statute, while also abolishing the ancient procedural distinctions on review for a natural division which preserves the jury trial intact, but leaves all other trials subject to review. The rule stated in the third sentence of *subdivision (a)* accords with the decisions on the scope of the review in modern equity practice. See *Silver King Coalition Mines Co.* v. *Consolidated Mining Co.*, 204 Fed. 166 (C. C. A. 8th, 1913), cert. den. 229 U. S. 624 (1913); *Warren* v. *Keep*, 155 U. S. 265 (1894); *Furrer* v. *Ferris*, 145 U. S. 132 (1892); *Tilghman* v. *Proctor*, 125 U. S. 136, 149 (1887); *Kimberly* v. *Arms*, 129 U. S. 512, 524 (1889)."

pp. 149-150, April 1937 "Report of the Advisory Committee on Rules for Civil Procedure appointed by the Supreme Court of the United States".

The notes of the Advisory Committee to Rule 52 (a), as it finally appears, reiterate that

"the rule stated in the third sentence of *Subdivision (a)* accords with the decisions on the scope of the review in modern federal equity practice. It is applicable to all classes of findings in cases tried without a jury whether the finding is of a fact concerning which there was conflict of testimony, or of a fact deduced or inferred from uncontradicted testimony."

28 U. S. C. A., following Section 723 c.

At the American Bar Association Institute on the Federal Rules, held at Cleveland, Ohio, in July, 1938, William D. Mitchell, Chairman of the Supreme Court Advisory Committee, said, concerning Rule 52 (a),

"The existing law is that in a jury-waived case, the findings of fact can be set aside in the appellate court only if there is no substantial evidence to sup-

port them; and the equity rule is that on an appeal the appellate court may review the evidence and if it finds that the findings are clearly erroneous, that is, against the clear weight of the evidence, it may set them aside. By this union we had to adopt one rule or the other for both cases and we adopted the equity rule and *broadened* the scope of review that is now allowed in appeals from cases tried by a judge where the jury was waived." (Italics ours.)

p. 368, "Federal Rules of Civil Procedure and Proceedings of the American Bar Association Institute—Cleveland 1938."

Further, the language of the rule is simple and clear:

"Findings of fact shall not be set aside unless clearly erroneous * * *"

Petitioner argues that the Circuit Court of Appeals cannot review the evidence, but can only review the findings of fact.

It neglects to indicate the manner in which the Circuit Court of Appeals can determine whether the findings of fact are clearly erroneous without examining the evidence.

The petitioner, in making such a distinction, not only ignores the cases it cites, but also overlooks that portion of Rule 52 (b) of the Federal Rules of Civil Procedure which recites:

"When findings of fact are made in actions tried by the court without a jury, the question of the sufficiency of the evidence to support the findings may thereafter be raised * * *."

28 U. S. C. A., following Section 723 c.

The petitioner also apparently contends that the Circuit Court of Appeals cannot reverse without stating that the findings of fact are "clearly erroneous".

There is no such requirement in the rule. However, such a statement is implicit in the statement of the Circuit Court of Appeals that

> "The district court upheld this defense with a considered opinion. 37 F. Supp. 546. We are constrained to disagree" (R. 347).

This language also answers the contention that the Circuit Court of Appeals ignored the trial judge and his conclusions.

Petitioner's claim that "the Circuit Court of Appeals misconceived its power in the instant case" in that it exercised other than its appellate jurisdiction (Petition, p. 14) is baseless, since all that the Court did was to exercise its appellate jurisdiction in conformity with Rules 52 (a) and (b).

The Circuit Judge who wrote for the Court, Honorable Charles E. Clark, was the Reporter under whose supervision Rule 52 was drafted (April 1937 "Report of the Advisory Committee on Rules for Civil Procedure appointed by the Supreme Court of the United States", p. VII), and it is perhaps needless to observe that the rule and its development were quite familiar to him. See "Review of Findings of Fact" by Charles E. Clark and Ferdinand F. Stone, 4 Univ. of Chicago Law Review 190-217 (1937).

The Circuit Court of Appeals for the Second Circuit made no interpretation of Rule 52 (a) in conflict with any holding of another Circuit Court of Appeals.

An examination of all of the cases cited by petitioner (Petition, pp. 14-21) will reveal that, in each, the "clearly erroneous" test set forth in Rule 52 (a) was applied.

A most lucid statement concerning the application of Rule 52 (a) may be found in *Kuhn* v. *Princess Lida of*

Thurn & Taxis, 119 F. (2d) 704, 706 (C. C. A. 3rd, 1941), where the Court said:

> "The sufficiency of the evidence to sustain a trial court's conclusion or finding of an ultimate fact remains appropriate matter for an appellate court's consideration. State Farm Mutual Automobile Insurance Co. v. Bonacci et al., 8 Cir., 111 F. 2d 412, 415. Where the evidentiary facts are not in conflict or dispute, the conclusions to be drawn therefrom are for the appellate court upon review of the trial court's action. Cf. United States v. South Georgia Railway Co., 5 Cir., 107 F. 2d 3, and United States v. Mitchell, 8 Cir., 104 F. 2d 343, 346. An incorrect conclusion by a trial court qualifies as a 'clearly erroneous' finding, for the correction whereof on appeal Rule 52 (a) specifically provides."

Mr. Justice Reed in *Palmer* v. *Connecticut Railway & Lighting Co.*, 311 U. S. 544, 558 (1941), referred to the precise situation involved in the case at bar, saying:

> "The petitioner also contends that the circuit court of appeals erred in setting aside the district court's decree refusing the claim on the ground that the evidence, detailed above, did not satisfy the mind as to the amount of damages. In the view of the trial court, there was a failure of proof. *The correctness of the judgment of the appellate court in directing an allowance of the claim depends not upon its power, which we think is clear*, but upon its conclusion as to the persuasive character of the evidence, whether it is too speculative, whether it showed the damage to reasonable certainty. As there was no significant dispute over the facts proven, the conclusion as to the sufficiency of the evidence was for the reviewing court." (Italics ours.)

Since the trial court and the appellate court in the case at bar found that there was no substantial dispute as to the facts (R. 319, 349), the sufficiency of the evidence to establish a pledge was, under the rule laid down by this court in *Palmer* v. *Connecticut Railway & Lighting Co.*, *supra*, for the reviewing court.

The Circuit Court of Appeals took exception to the conclusions of the trier of the facts, and this was clearly within its province under the rule and the decided cases.

Petitioner misconceives the import of the decisions in some of the cases which it cites, for example: This is not a case where the power of the Circuit Court of Appeals over an administrative body is sharply curtailed by a statute as in *Wilmington Trust Co.* v. *Helvering*, 86 L. Ed. 908 (not yet officially reported) (1942) (*involving a tax statute limiting the power of the appellate court to reverse or modify only if "not in accordance with law"*); and as in *National Labor Relations Board* v. *Waterman Steamship Corp.*, 309 U. S. 206 (1940) (*Statute creating National Labor Relations Board and making its findings conclusive.*)

Nor is it a case where a Rule was silent as to the power of a Circuit Court of Appeals. *Halliday* v. *United States*, 315 U. S. 94 (1942) (*Federal Rule of Civil Procedure 50, where the power of the Circuit Court of Appeals to reverse and direct entry of judgment without a new trial was questioned*).

That portion of Rule 52 (a) of the Federal Rules of Civil Procedure here involved, which petitioner claims is new and not clear, is merely a codification in statutory form of a rule which has been established by the decisions of this court and of the lower appellate courts over a long period of years. The fact, that the rule is now embodied in statute rather than case law, hardly warrants any further clarification.

Confusion there is none, except such as petitioner creates by ignoring the historical background of Rule 52 (a).

POINT II.

The findings of fact of the trial court having been set aside by the appellate court as not sustained by the evidence, this Court should not under its established practice grant certiorari to review the evidence.

Petitioner asserts that the findings of fact signed by the District Judge were not clearly erroneous, and that the Circuit Court of Appeals therefore erred in setting them aside. The determination of this claim involves a review of the evidence by this Court.

It is respectfully submitted that this ground is wholly inadequate, under this Court's settled practice to deny certiorari where the purpose is merely to obtain a review of the evidence or inferences drawn therefrom.

> *General Talking Pictures Corp.* v. *Western Electric Co.*, 304 U. S. 175, 178 (1938);
> *Southern Power Company* v. *North Carolina Public Service Company*, 263 U. S. 508 (1924).

In view, however, of the severe criticism of the Circuit Court of Appeals in the petitioner's brief, it may not be amiss to indicate the evidence in the record, and the statements of the trial judge, which show that the conclusion reached by the trial judge concerning possession in petitioner (and a consequent common-law pledge) was clearly erroneous, as was the conclusion that petitioner had no reasonable cause to believe that a preference would be effected.

(A) As to the Common-Law Pledge.

There was at no time a controversy as to the rule of law applicable to determine whether petitioner had a valid common-law pledge.

Although the situs of the merchandise attempted to be pledged was at all times in the State of Virginia, no contention was at any time made that the rule, enunciated in the decisions of this Court and of the Circuit Court of Appeals for the Second Circuit, was not the universal and established common-law rule.

> "* * * a pledge is not valid * * * if there is a mere contract for a pledge, and not an actual pledge."
> *Casey* v. *Cavaroc*, 96 U. S. 467, 484 (1878)

> "Delivery of possession is the very life of a pledge. No mere agreements respecting possession can create it. The contract of pledge cannot exist outside of the fact of change of possession. The pledgor must dispossess himself, openly, completely, unequivocally, and 'without deceptive combinations which lead third persons into error as to the real possessor of the thing'."
> *Security Warehousing Co.* v. *Hand*, 143 Fed. 32, 41 (C. C. A. 7th, 1906), affirmed 206 U. S. 415 (1907).

The trial judge, in his opinion, stated the applicable rule:

> "* * * the requirement frequently stated and much relied upon by the plaintiff, that possession of the pledged property must clearly and unmistakably pass to the pledgee (*Casey* v. *Cavaroc*, 96 U. S. 467; *Security Warehousing Company* v. *Hand*, 206 U. S. 415; *Hamilton Ridge Lumber Sales Corporation* v. *Wilson*, 25 Fed. (2d) 592; *Ryttenberg* v. *Schefer*, 131 Fed. 313; *Ommen* v. *Talcott*, 188 Fed. 401; *In re Merz*,

37 Fed. (2d) 1), is so well established in the law that it is not open to discussion" (R. 319-320).

and the reason for the rule (quoting Judge Swan in *Irving Trust Co.* v. *Commercial Factors Corporation*, 68 F. (2d) 864, 866 (C. C. A. 2nd, 1934)):

"* * * to prevent possession by the pledgor (Deford here) from giving him a false credit" (R. 321).

The burden of establishing its security title of pledge was upon petitioner. *In re Circle Trading Corporation*, 26 F. (2d) 193, 195 (C. C. A. 2nd, 1928).

And in sustaining the burden, it was incumbent upon petitioner to prove notice, to would-be creditors, of its alleged lien. *In re Master Knitting Corporation*, 7 F. (2d) 11, 12 (C. C. A. 2nd, 1925).

No effective means to give notice to unsuspecting creditors was employed by petitioner.

The contract between petitioner and The Deford Company was nowhere recorded or filed (R. 150).

Small inconspicuous signs were placed outside of various buildings, although large prominent signs bore the name of The Deford Company (Plaintiff's Exhibits 7-26, R. 176-215, 93-110).

The visible signs certainly failed to indicate that property in The Deford Company's premises was pledged to petitioner.

An advertisement was published in a local semi-weekly newspaper twice a week for two weeks (R. 41, 246).

The notoriety secured by the publication in the Luray newspaper was short-lived. The publication was for two weeks in December of 1936 (R. 246). The arrangement between petitioner and The Deford Company lasted until the filing of the bankruptcy petition in July of 1938.

So far as Long is concerned, his own testimony negatives any control, dominion, or possession by petitioner through him.

Long's testimony makes it abundantly clear that there was no change of possession from the bankrupt to petitioner:

> "The Court: * * * After November 1, 1936, did you do anything that you did not do before that time?
>
> The Witness: Is that the question?
>
> The Court: Yes.
>
> The Witness: Well, I went to see the green hides as they come in, and I kept a little record, a little pocket book record of them.
>
> Q. You did that after November 1? A. Yes.
>
> Q. And did you not do it before November 1st? A. I did not do it before.
>
> Q. Now what else? A. Well, that was perhaps all. I did the rest of the routine business the same" (R. 123).

The Circuit Court of Appeals was impelled to observe:

> "Thus, the attempted legal shift of control was little more than a matter of lip service to the rules. Actually, business went on as before" (R. 349).

Judged by the rule expressed in the decided cases, petitioner's possession neither existed, nor was it open or notorious.

> *Security Warehousing Co.* v. *Hand*, 206 U. S. 415 (1907);
>
> *Casey* v. *Cavaroc*, 96 U. S. 467 (1878);
>
> *Hamilton Ridge Lumber Sales Corporation* v. *Wilson*, 25 F. (2d) 592 (C. C. A. 4th, 1928);
>
> *Ommen* v. *Talcott*, 188 Fed. 401 (C. C. A. 2nd, 1911), appeal dismissed, 231 U. S. 761 (1913);
>
> *In re Merz*, 37 F. (2d) 1 (C. C. A. 2nd, 1930), certiorari denied (*Degener* v. *Boyd*), 281 U. S. 738 (1930);

Ryttenberg v. *Schefer*, 131 Fed. 313 (United States District Court, Southern District, New York, 1904);

In re Spanish-American Cork Products Co., 2 F. (2d) 203 (C. C. A. 4th, 1924), certiorari denied (*Western National Bank of Baltimore* v. *Chapman*), 266 U. S. 634 (1925).

The basic rule is clear: complete, exclusive possession and dominion, and adequate notoriety.

The trial judge recognized the weakness in petitioner's attempted possession. In his opinion, at one point he stated that "he (Long) continued to function under the new arrangement in all substantial respects as prior to the date of the contract" (R. 322); at another point he characterized the petitioner's possession as "informal" (R. 324); at still a third point, he concluded that the possession of the hides and unfinished leather, during the process of conversion, was "something less than meticulous" (R. 323); and finally, he observed that "it cannot be said that Long was the exclusive custodian of the hides and finished leather in the sense that none of the latter moved from the plant except with his authority" (R. 322).

The trial judge was doubtless misled by many elements: that a pledge was intended (R. 323), an element dismissed in *Casey* v. *Cavaroc*, *supra*, p. 18; that "the plant at Luray was remote from the paths of trade" (R. 324), a statement unsupported by the evidence; and that money advanced by petitioner purchased the hides (R. 324), an element that has been adjudged to be immaterial (*Lichtenberg* v. *Harvey*, 57 F. (2d) 82, 83 (C. C. A. 2nd, 1932).

The trial judge inferred that merchandise creditors conducted their transactions at the Baltimore office of The Deford Company, rather than at the plant (R. 321), a wholly unwarranted inference. Moreover, there was no proof that there were any signs at the Baltimore office

to warn creditors that their goods would be subject to any lien of petitioner.

Further, whereas the burden was upon petitioner to show sufficient notoriety (*In re Circle Trading Corporation, supra,* p. 19; *In re Master Knitting Corporation, supra,* p. 19), the trial judge placed the burden on the trustee when he said in his opinion:

> "* * * creditors dealing with Deford are not shown to have visited the premises for the purpose of selling hides and tanning supplies, or otherwise; * * *" (R. 324).

Nor did petitioner show that any creditor of The Deford Company received any of the commercial agency reports introduced into evidence by petitioner (R. 290-305, 135-137), nor was the precise and detailed nature of the arrangement between The Deford Company and petitioner outlined therein.

The Circuit Court of Appeals examined the evidence introduced in support of petitioner's alleged lien and concluded that the decision of the trial judge, finding possession and a valid common-law pledge in petitioner, was clearly erroneous.

The conclusion of the Circuit Court of Appeals was amply supported by the evidence, as the conclusion of the trial judge was not.

Certiorari should not be granted to review again this question of fact. The underlying law has been long settled by the decisions of this Court.

(B) As to Reasonable Cause to Believe That a Preference Would Be Effected.

Petitioner further maintains that the Circuit Court of Appeals erred in setting aside, as clearly erroneous, the conclusion of the trial judge (R. 329), that petitioner

did not have reasonable cause to believe that a preference would be effected through the receipt of the assigned accounts.

Preliminarily, attention should be fixed upon the statute here in question—Section 60 (b) of the Bankruptcy Act.

Prior to 1910, it was incumbent upon a trustee in bankruptcy, in a preference case, to prove as one of the necessary elements that—

> "* * * the person receiving it, or to be benefited thereby, or his agent acting therein, shall have had reasonable cause to believe that it was *intended* thereby to give a preference." (Italics ours.)
>
> *Section 60(b) of the Bankruptcy Act* (see Historical Note to 11 U. S. C. A., Section 96(b) (1927 edition)).

This was the test applied in *Ryttenberg* v. *Schefer*, 131 Fed. 313, 317 (United States District Court, Southern District, New York, 1904).

Intent was deleted from the statute in 1910 (see Historical Note to 11 U. S. C. A., Section 96(b), cited *supra*), and the relevant language is as follows:

> "* * * and the person receiving it or to be benefited thereby, or his agent acting therein, shall then have reasonable cause to believe that the enforcement of such * * * transfer would effect a preference."
>
> *Section 60 (b) of the Bankruptcy Act*, 11 U. S. C. A., Section 96(b) (before the Chandler Act amendment).

The Bankruptcy Act, by virtue of the Chandler Act amendments, no longer requires a showing that the recipient of a preference shall have had reasonable cause to believe that the transfer would effect a preference (11 U. S. C. A., Section 96 (b)).

Although this case arose prior to such amendment, any pronouncement by this Court, concerning an element sustaining a preference under the Bankruptcy Act as it previously existed, seems to be unnecessary.

Whether there is reasonable cause to believe, that a transfer would effect a preference, is a question of fact. *Kaufman* v. *Tredway*, 195 U. S. 271, 273 (1904); *Pyle* v. *Texas Transport & Terminal Company*, 238 U. S. 90, 98 (1915).

This Court will not ordinarily grant certiorari to review fact questions. *General Talking Pictures Corp.* v. *Western Electric Co., supra*, p. 17.

In presenting his proof, the trustee established a *prima facie* case. Cf. *Lichtenberg* v. *Harvey*, 57 F. (2d) 82 (C. C. A. 2nd, 1932).

The transfers were established (R. 24-25, 26-27). Knowledge of insolvency was conceded (R. 12, 15-18). That petitioner received a greater percentage of its debt than other creditors was shown (R. 24, 26, 28, 30).

Reasonable cause to believe that the transfer would effect a preference was *prima facie* established from the facts shown—the receipt by petitioner of periodic statements showing large deficits of The Deford Company over a period of almost two years (R. 13, 22-24), a suspension of operations by The Deford Company (R. 21), a continuously declining leather market (R. 21), knowledge of the insolvency of The Deford Company (R. 12, 15-18), and worry by petitioner's president about the debt to petitioner (R. 21-22).

The trial court, in denying petitioner's motion to dismiss at the close of the trustee's case, held that the trustee had made out a *prima facie* case (R. 35-37).

Without proof by petitioner, a decree in the trustee's favor would have been rendered.

The trial judge predicated his conclusion, that there existed no reasonable cause in petitioner to believe that a preference would be effected, upon the existence of what he believed to be a valid common-law lien by way of pledge. He said in his opinion:

> "The conclusion, that there was created such a lien as has been stated above, negatives a belief that a preference would be effected through the receipt of the assigned accounts * * *" (R. 329).

In *Irving Trust Co.* v. *Bank of America Nat. Ass'n.*, 68 F. (2d) 887, 888 (C. C. A. 2nd, 1934), certiorari denied, 292 U. S. 628 (1934), the Court said:

> "The bank received the deposit under circumstances which gave it reasonable cause to believe that a preference would be effected thereby, unless as a matter of law the loan agreement justified retention of the deposit * * * the evidence would have justified no other conclusion."

As a matter of law no pledge existed, consequently the trustee's case against petitioner was defenseless.

If a creditor may be heard to say that he had no reasonable cause to believe that the transfers would effect a preference because he believed that he had a good lien, although none as a matter of law existed, no recovery could ever be had by a trustee in bankruptcy.

Petitioner's reasonable cause to believe, that a preference would be effected, was amply established by the evidence, and a finding to the contrary, predicated upon a claim of lien which was non-existent, was clearly erroneous.

The Circuit Court of Appeals was right in setting the findings aside.

POINT III.

Perfecting an imperfect pledge within four months preceding bankruptcy, under the rule referred to as the "relation back" doctrine, depends for its effectiveness upon the laws of the several states.

Diversity of decisions, if any, stems from the "local" application of the rule.

The final ground upon which petitioner bases its application for a writ is the alleged misapplication by the Circuit Court of Appeals of the "relation back" doctrine, as it existed prior to the Chandler Act amendments to the Bankruptcy Act, for it exists no longer in bankruptcy.

Briefly defined, the "relation back" doctrine, as applied to bankruptcy, permitted a creditor to perfect, during the four months preceding bankruptcy, an imperfect lien created outside of the four months' period.

The acts done within the four months of themselves would constitute a voidable preference; the prior transaction of itself would not create a lien against the trustee in bankruptcy. By combining the two, however, by means of the "relation back" doctrine, under certain circumstances the imperfect lien was held to have been validated. See Note, 28 Columbia Law Review, 943 (1928).

The perfecting was held to "relate back" to the date of the original agreement.

As was stated by Mr. Justice Field, in *Gibson* v. *Chouteau*, 80 U. S. 92, 100-101 (1872), a non-bankruptcy case:

> "By the doctrine of relation is meant that principle by which an act done at one time is considered by a fiction of law to have been done at some antecedent period."

A pledge may be taken by way of illustration, since it is the subject matter of the case at bar. An agreement to pledge, without the necessary delivery of possession to the pledgee, was uniformly held ineffective to create a valid lien. *Supra,* page 18. However, courts in some instances have allowed possession obtained within the four months' period, to perfect the prior transaction as a pledge, enforceable against the trustee in bankruptcy. *Sexton* v. *Kessler & Company Limited*, 225 U. S. 90 (1912), is perhaps the most notable instance.

It should be emphasized at the outset, however, that the "relation back" doctrine was not a doctrine of general law universally applied.

Only when a valid pledge was created by state law by the acts done during the four months' period, could the bankruptcy courts consider the lien perfected against the trustee.

Thompson v. *Fairbanks*, 196 U. S. 516 (1905);
Sexton v. *Kessler & Company, Limited*, 225 U. S. 90 (1912);
Humphrey v. *Tatman*, 198 U. S. 91 (1905);
Finance & Guaranty Company v. *Oppenhimer*, 276 U. S. 10 (1928);
Hiscock v. *Varick Bank of New York*, 206 U. S. 28 (1907).

See also,

Note, 28 Columbia Law Review, 943 (1928).

As Mr. Chief Justice Fuller stated, in *Hiscock* v. *Varick Bank of New York, supra*:

> "The questions of the extent and validity of the pledge were local questions, * * *." (206 U. S. at 37, 38).

The local factor in the application of the "relation back" doctrine produces the variability of result in the various Circuit Courts of Appeal, and petitioner, in failing to take this into account, arrives at the conclusion that there is a conflict. See Note, 34 Yale Law Journal, 891, 892 (1925).

> "As to questions controlled by state law, however, conflict among circuits is not of itself a reason for granting a writ of certiorari. The conflict may be merely corollary to a permissible difference of opinion in the state courts."
>
> *Rublin* v. *New York Life Insurance Co.*, 304 U. S. 202, 206 (1938).

In the Circuit Court of Appeals, petitioner first urged that the assignments of the accounts receivable during the four months' period "related back" to the date of the original 1936 agreement. In other words, petitioner argued, the assignments were to be considered to have been made in 1936. This contention, not now seriously urged by petitioner, was disposed of by the Circuit Court of Appeals in these words:

> "Finally, defendant argues that the assignments of accounts during the four months preceding bankruptcy relate back to the date of the agreement. This is clearly erroneous. In 1936, there was only an agreement to assign and, as we have held, no valid lien upon the hides and leathers. Hence, until the accounts came into existence, no security could exist; and until actually assigned, the security interest did not exist" (R. 350-351).

This statement is in accord with New York and Virginia law.

> *Okin* v. *Isaac Goldman Co.*, 79 F. (2d) 317 (C. C. A. 2nd, 1935);

In re Modell, 71 F. (2d) 148 (C. C. A. 2nd, 1934);
Seaboard Small Loan Corporation v. *Ottinger*, 50 F. (2d) 856 (C. C. A. 4th, 1931; appeal from the District Court of the United States for the Western District of Virginia);
Lone Star Cement Corporation v. *Swartwout*, 93 F. (2d) 767 (C. C. A. 4th, 1938; appeal from the District Court of the United States for the Eastern District of Virginia).

All that petitioner now says is that the court below erred in holding that no security could exist until the accounts came into existence (Petition, p. 33).

No authorities are cited to sustain this claim of error.

The remaining ground, involving the "relation back" doctrine, now urged is the failure of the Circuit Court of Appeals to hold that the petitioner perfected its pledge by taking possession of the proceeds of the leather, as represented by the accounts.

This contention was disposed of in the Court below, Judge Clark saying:

> "Nor can the procedure followed be fairly assimilated to the taking of actual possession under an equitable pledge, for that never happened. Instead, Deford delivered possession to its vendees; and having thus created a new property in itself, by way of claim against the vendees, it assigned that to defendant. Thus fairly considered, there were two separate steps, not merely the one step of perfecting a heretofore imperfect pledge" (R. 351).

We now discuss some of the cases cited by petitioner to sustain the argument that the assignments of accounts ought to be viewed as taking possession of the leather.

Petitioner quotes from *Irving Trust Co.* v. *Bank of*

America Nat. Ass'n., 68 F. (2d) 887 (C. C. A. 2nd, 1934), certiorari denied 292 U. S. 628 (1934), the following:

> "Since delivery of the securities themselves would not have been a preferential transfer to the lienor, the delivery of their proceeds, pursuant to the agreement, could not be" (68 F. (2d) at 889).

In that case the bankrupt, the day preceding the filing of the bankruptcy petition, made a deposit in its account with the defendant bank, and approximately $82,000 of the said deposit was applied to the payment of a "day loan" made by the bank to the bankrupt earlier in the day. The loan was to be secured by a lien upon securities to be purchased with the avails of the loan. The court said at page 889:

> "But the 1916 amendment to section 230 of the Lien Law expressly validates as against creditors liens upon securities agreed to be pledged for a day loan. The use of the word 'creditors' without any qualification or explanation in this statute includes, of course, execution or attachment creditors, and it follows that such a lien would also be valid as against the lienor's trustee in bankruptcy. Consequently, we hold that the defendant had a valid lien upon the securities obtained by the bankrupt by the use of the day loan."

The statement quoted by petitioner, and plucked from its context, becomes clear when the reasons for this holding are made to appear.

Except for the statute, the creditor in the case in question would not have had a valid lien, but, since the statute fixed the lien, the creditor could take the property as against the trustee. It therefore followed as a necessary corollary that the creditor could take the proceeds.

In the case at bar there was no valid lien for want of possession and notoriety; the accounts receivable created

by the sale by bankrupt of its leather were not "proceeds" to take the place of the pledge, for there was no pledge.

Thompson v. *Fairbanks*, 196 U. S. 516 (1905), is of little assistance in determining the question in this case. It merely indicates that Vermont permits the application of the "relation back" doctrine to mortgages of after-acquired property—taking possession of the property during the four months' period was held to relate back to the date of the mortgage.

> "In some states this is the law with respect to an assignment of property to be acquired in the future. Thompson v. Fairbanks, 196 U. S. 516, 25 S. Ct. 306, 49 L. Ed. 577. But in New York the rule is otherwise * * *"
>
> *In re Modell*, 71 F. (2d) 148, 149 (C. C. A. 2nd, 1934).

Finance & Guaranty Company v. *Oppenhimer*, 276 U. S. 10 (1928), simply holds that, in Virginia, a conditional vendor with a duly recorded conditional sales contract may repossess himself of the goods within ten days of the filing of the bankruptcy petition, thus giving effect to a valid lien.

Sawyer v. *Turpin*, 91 U. S. 114 (1875), presents an entirely unrelated problem. There a valid bill of sale, given before the four months' period, was cancelled during the four months' period and a mortgage was given in lieu of it. The giving of the mortgage was held not to be a preference, for "an exchange of securities within the four months is not a fraudulent preference * * * if the security given up is a valid one when the exchange is made * * *" (91 U. S. at 120). The opinion rests largely upon Massachusetts law.

Petitioner analogizes the situation in the *Sawyer* case to the case at bar by the statement—"the assignment

of the accounts, like the chattel mortgage, was merely a substitution of more effective legal security" (p. 34, Petition). But there was no *valid effective legal* security surrendered here, and there was no exchange of securities. All that occurred was that an unsecured creditor, with no security, received funds from the bankrupt, within the four months period prior to bankruptcy.

In *Britton* v. *Union Inv. Co.*, 262 Fed. 111 (C. C. A. 8th, 1919), certiorari denied, 252 U. S. 580 (1920), cited by petitioner, the facts detailed in the opinion are rather meagre. They nevertheless indicate a taking of the physical possession of the merchandise through the instrumentality of a creditors' committee during the four months' period. The Committee sold the merchandise with the consent of the pledgee and of the bankrupt, and paid the funds over to the pledgee. Thus there was a taking of possession of the merchandise through the agency of the creditors' committee (262 Fed. at 112).

In the instant case, of course, petitioner never obtained possession of the merchandise; it was sold by The Deford Company to its customers; and it was never delivered to the petitioner either actually or constructively. The petitioner was therefore a creditor without a pledge or lien, and by reason thereof, an unsecured creditor.

Crosby v. *Packer*, 22 F. (2d) 611 (C. C. A. 1st, 1927), presents the final "conflict" urged by petitioner. The situation there presented is a peculiar one, and is determined by application of State law. There, a guardian "borrowed" his ward's money, "intending" that certain real estate he owned "should be held as security." During the four months' period prior to his bankruptcy, he sold the realty and deposited the proceeds in the account of his ward. The Court sustained the payment, stating that Massachusetts law, "where this contract was made", recognized an agreement creating "equitable interests in property" (22 F. (2d) at 613).

Doubtless many more cases can be cited showing that the Circuit Courts of Appeal in the various Circuits differed in the many and varied applications of the "relation back" doctrine. The confusion suggested by petitioner derives from a failure to read these decisions and to observe the admonition of Mr. Justice Vann of the New York Court of Appeals in *Zartman* v. *The First National Bank of Waterloo*, 189 N. Y. 267, 273, 82 N. E. 127 (1907):

> "In reading the authorities it is important to observe how, where and between whom the questions arose * * *"

Petitioner does not maintain that the Circuit Court of Appeals misinterpreted or misapplied Virginia law. No attempt is made by petitioner to show that Virginia law is contrary to that enunciated by the Circuit Court of Appeals, Second Circuit.

Petitioner merely relies upon a "conflict" among the Circuits. It is submitted that this Court should follow its settled rule and not allow certiorari, where the conflict, if any, is based on differing local law.

Further, there is no serious question of importance here to be considered. No longer may a creditor who attempted to create a lien, which he fails to perfect and which he keeps secret for purposes best known to himself, perfect his lien as against a trustee in bankruptcy when his debtor is insolvent, and his debt endangered.

The Chandler Act amendments to the Bankruptcy Act legislated out of existence the "relation back" doctrine, so far as the trustee in bankruptcy is concerned. See Glenn, "The Chandler Act and the Trustee as a Bona Fide Purchaser; A Supplementary Note", 25 Va. Law Rev. 885 (1939); Collier on Bankruptcy (14th Edition), vol. 3, pages 891 *ff.*

As stated in Collier's (*ibid*, pp. 977-979):

> "Accordingly, the 1938 Act, by virtue of the last sentence of Section 60a, has made a complete change in the law. It is now provided that the preferential character of a transfer *must* be considered as of the time when the last act is done which is necessary under state law to perfect the transfer against *bona fide* purchasers and creditors of the transferor. This prevents application of the 'relation back' doctrine, and serves to strike down equitable liens or assignments resulting in preferential transfers. It means that whenever the last act is done which under state law so perfects the equitable lien or equitable assignment that it is good against both a *bona fide* purchaser or creditors, that will be the time to determine whether a preference has been effected."

The Chandler Act amendments having entirely disposed of this doctrine as affecting a trustee in bankruptcy, it requires no clarification, since the question is now academic.

POINT IV.

The petition should be denied.

Respectfully submitted,

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